

Alternative Fees Versus Hourly Billing

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Alternative fee arrangements are "in" again. Some say they are a temporary trend and the billable hour will reign supreme once the economy improves. It is more likely alternative billing is here to stay for two reasons. First, alternative fee arrangements never disappeared after they last were in vogue in the 1990s, but they did stop getting press because the biggest law firms were grabbing headlines by commanding top dollar for hourly billing. Second, today's in-house counsel find a lot to like about alternative fee arrangements and will be reluctant to abandon them in the future.

Guiding Principles

Trust, fairness and transparency — if a fee proposal has these three features, it is likely to succeed. The attorney-client relationship requires a foundation built on trust. This is as true in the billing arena as it is when it comes to devising strategy regarding the merits of a case. Moreover, in any complex and ongoing business relationship, both sides must feel the deal is fair, or the relationship will not last. The key to building a fair and trusting relationship is transparency. A transparent billing relationship allows you and your client to see how fees are generated and risks are shared. In this scenario, neither party is likely to regret making the deal.

When structuring a fee arrangement for a new matter, the first and most important thing to do is determine what matters most to your client with respect to the particular case or transaction. Then, tie a risk and a reward to the client's top priority. If the client cares most about prevailing on the merits, use some version of contingency billing to tie your reward to the result. On the other hand, if the client places the greatest value on getting an early settlement, tie your reward to that achievement by, for example, reducing a pre-set bonus every month the case remains unresolved. Or, if your client's top priority is the efficient processing of a series of cases, tie the reward to keeping the average fees-per-matter within the client's budget.

The point is to create a partnership in which the client's goals become your goals. As attorneys, we believe in our hearts that we always put clients' best interests first and certainly ahead of our own. This partnership will be strongest when your financial interests are aligned with those of the client.

Comcast Corp.'s General Counsel Arthur Block puts it this way: "The objective is to get a sense that the law firm is managing its own business more efficiently for our mutual benefit so they have some skin in the game. We are not looking to be punitive; we are looking to be more businesslike. We can be creative. We want them to be creative."

Rethinking the 'Billable Hour'

After decades of hourly billing, many attorneys can be forgiven for feeling like they are selling their time in hourly units. But clients are not buying our time. They are, rather, seeking our advice and specialized skills to solve problems. A creative alternative fee agreement can eliminate the disconnect between what the client wants to buy and what attorneys are really offering.

If the groundwork is laid properly, your client's primary goal is well-understood, a risk/reward is tied to that goal, and you and your firm have "some skin in the game," then both you and your client should have no difficulty working through any issues that might arise as the work proceeds.

Remember, neither side wants the billing arrangement to create tension. Lawyers don't want clients to be unhappy — after all, the most valuable reward for any lawyer is future business. For clients, an unhappy lawyer might mean that other clients' problems take priority over their own.

Types of Alternative Fee Arrangements

The contingency fee is a form of alternative billing that lies at the extreme end of the risk-sharing spectrum for attorneys. In this scenario, the attorney or firm assumes virtually all risk. On the other end of the spectrum, hourly billing places almost all of the risk on the client.

Many times, the midpoint works well, especially for commercial plaintiffs' litigation, where the client and attorney are willing to share the risk. The firm bills half its regular hourly rate, which the client pays as accrued. The half-rate discount is then coupled with a contingency, giving the lawyer a percentage of any recovery/savings. The choice of a particular point along the contingency spectrum (half regular rate plus one-sixth recovery, or two-thirds regular rate plus 10 percent recovery, etc.) will be influenced by a client's and lawyer's predictions of the most likely result and the probable cost to get there. Costs can be paid as incurred, or they can be advanced by the lawyer.

Modified contingency billing is the one choice of fee arrangement most likely to encourage teamwork between attorney and client because both truly share the risks and the benefits. While this form of alternative billing neither maximizes nor minimizes the cost of the litigation or transaction, it should maximize the client's confidence that you are behaving in its best interests.

Blended Billing

If a client is focused less on the end result and more on reducing the cost to get there, a blended billing rate is likely to be the alternative fee deal of choice. A blended rate refers to a rate calculated by multiplying the hours worked times a single negotiated fee amount, no matter who does the work.

Because the blended rate will be lower than a firm's senior-most lawyer's standard billing rate, there is a strong incentive for the firm to assign tasks to the most junior attorney capable of handling them competently. This scenario benefits the cost-conscious client by ensuring that routine tasks are not done by high-priced talent, and it benefits the firm by providing learning opportunities for junior lawyers. The downside for the firm is that senior lawyers may not be appropriately compensated for the time they devote to the matter. This can be addressed by, for example, agreeing that once trial begins, standard (or enhanced) rates will apply.

Target Billing Goal

When the client is willing to pay for your representation, but is wary of a runaway bill, a fee structure should be created to incentivize you and your firm to maximize efficiency. Such a fee structure is known as a "Target Billing Goal."

In a Target Billing Goal structure, an attorney and client together set an amount (or range) that they jointly believe to be the most likely hourly-fee bill for a particular case or sub-part of a case (such as the discovery phase). If the invoices, as measured by standard hourly rates, exceed that targeted amount, then the client pays only half of the excess. If, however, the standard hourly bills fall below the targeted amount, then the client pays half the difference. If attorneys are efficient and accomplish their work for less than the amount predicted, they are rewarded with a financial bonus. If, however, they do not accomplish their work for the targeted amount, they are penalized financially.

How does the Target Billing Goal model influence a lawyer's behavior? First, both the client and the lawyer have an incentive to set the target amount as accurately as possible because one of them is certain to lose if it is wrong. Logically, they will work closely together to analyze the expected effort and cost, a process that builds team work between lawyer and client and helps both to make realistic decisions about strategy, tactics and achievable results. After the target figure is selected, the lawyer is motivated not only to meet the target, but to beat it. The client benefits either way: if the target is exceeded, it receives legal services for half-price; if the bills are below the target, the client pays less than predicted, even after rewarding the lawyer.

Fixed Fees

For some clients, the most important thing is not how much a matter will cost, but rather whether the cost will match the amount budgeted. Certainty and predictability are important, especially for large organizations. Sometimes clients in this situation are willing to risk paying more in exchange for knowing the final amount beforehand. For these types of clients, fixed fees can work well.

Matters can be broken up into subparts and fixed fees set for some or all of the parts. Another variation is to fix the amount of fees for a certain time period (monthly or yearly). At some point, this approach approximates a retainer fee — another long-standing alternative fee arrangement.

How does a fixed fee motivate the attorney? In this scenario, there is substantial incentive to work efficiently, without involving more people than required to get the job done. Lawyers may find themselves working harder to cooperate with opposing counsel because usually more can be accomplished with less effort by cooperating, rather than fighting over every detail.

A variation on this structure is to put "collars" on fees. An attorney and client agree that a fee will be calculated via hourly billing, but neither exceed nor fall below a certain dollar amount, thus, fixing a fee within a range.

When Client Wants to be Number 1

In some instances, the client's top priority is knowing it is the attorney's top priority. This level of urgency may be triggered when: a lawsuit threatens the very existence of the company; a loss will set a precedent for numerous future lawsuits; or there is potential criminal liability. Clients should be willing to pay a premium to compete with other clients for your attention and advice, either by way of an enhanced hourly rate, a bonus, or both. A bonus can be a sum certain set in advance or a percentage of recovery/savings, or it may be measured as a percentage of the hourly fees. Sometimes a percentage of the hourly fees is held back by the client and only paid if its goal is reached.

Conclusion

As professionals, we should seek more in return for our efforts than money alone. We should enjoy the satisfaction of knowing the professional services provided were done well for a client that understands and appreciates the work and will hire the attorney again. Tested against that standard, appropriately chosen alternative fee arrangements beat hourly billing, hands down, every time.

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